

Accounting for Lease-Purchase Agreements (Capital Leases)

One of the most common ways school districts acquire equipment is through lease-purchase agreements. These transactions will include the general long-term debt account group and the fixed assets account group.

Governmental Accounting and Financial Reporting Standards (GASB Codification) Code Section L20.109 requires that a lease agreement that meets any one of the following criteria be capitalized:

1. The lease transfers ownership of the property to the lessee by the end of the lease term. *This is a common situation in LEAs.*
2. The lease contains a bargain purchase option. *This is a common situation in LEAs.*
3. The lease term is equal to 75 percent or more of the estimated economic life of the leased property.
4. The value at the beginning of the lease's term of the minimum lease payments, excluding that portion of the payments representing executory costs to be prepaid by the lessor but including any profit thereon, equals or exceeds 90 percent of the excess of the fair value of the leased property to the lessor at the inception of the lease.

When lease agreements are capitalized, the property rights acquired under the lease are reported in the general fixed assets accounts group (unless the property is acquired by an enterprise fund, an internal service fund, or a nonexpendable trust fund).

The following rules apply to accounting for capital leases in the governmental funds:

1. At the inception of the lease, record the capital lease in the fund acquiring the asset as a debit to Object 6000 for the amount of the entire principal that is due. The credit is to account 8972, Proceeds from Capital Leases.
2. At the inception of the lease, record in the general long-term debt account group the total principal that is due.
3. At the inception of the lease, record the asset in the general fixed assets account group. Record the asset at an amount equal to the total principal that is due.
4. As lease payments are made, record the payments in the fund acquiring the asset as a debit to accounts 7439, Debt Service-Principal, and 7438, Debt Service-Interest.

5. As lease payments are made, make entries to deduct the amount of principal paid from the general long-term debt account group.

As an example of accounting for a capital lease, assume that equipment is leased for a five-year period, which is the economic life of the equipment. The lease is signed on June 30, 1992, and beginning on this date, five annual payments of \$50,000 will be made.

The lease agreement contains the following amortization schedule which shows the breakdown of the annual payments into the principal and interest components:

Amortization Schedule

<i>Date</i>	<i>Lease Payment</i>	<i>Interest Expenditure @ 10%</i>	<i>Principal Expenditure</i>	<i>Amount of General Long-Term Debt¹</i>
6/30/92				\$208,493
6/30/92	\$ 50,000		\$ 50,000	158,493
6/30/93	50,000	\$15,849	34,151	124,342
6/30/94	50,000	12,434	37,566	86,776
6/30/95	50,000	8,678	41,322	45,454
6/30/96	50,000	4,546	45,454	-0-
	\$250,000	\$41,507	\$208,493	

¹This column was computed from the amortization schedule provided in the lease agreement. This column provides the figures to be used to reconcile the amounts recorded in the general long-term debt account group. To compute this column, subtract the amount of principal paid each year from the total principal due at the beginning of the lease.

This amortization schedule is necessary to make the entries that are needed to record the capital lease.

The following entries are made to record the lease:

June 30, 1992

General Fund

		<i>Dr</i>	<i>Cr</i>
6400	Equipment	\$208,493	
8972	Proceeds from Capital Leases		\$208,493
To record the acquisition of equipment with a capital lease			

General Fixed Assets Account Group

		<i>Dr</i>	<i>Cr</i>
9440	Equipment	\$208,493	
9690	Investment in General Fixed Assets		\$208,493
To record the asset			

General Long-Term Debt Account Group

		<i>Dr</i>	<i>Cr</i>
9685	Amount to Be Provided for Lease Payments	\$208,493	
9587	Obligation Under Capital Lease Agreements		\$208,493
To record the long-term debt resulting from a capital lease			

General Fund

		<i>Dr</i>	<i>Cr</i>
7439	Debt Service-Principal	\$50,000	
9110	Cash (Vouchers Payable)		\$50,000
To record the first lease payment			

General Long-Term Debt Account Group

		<i>Dr</i>	<i>Cr</i>
9587	Obligation Under Capital Lease Agreements	\$50,000	
9685	Amount to Be Provided for Lease Payments		\$50,000
To record the first payment (principal only)			

The second lease payment (6/30/93) would be recorded in the following manner:

General Fund

		<i>Dr</i>	<i>Cr</i>
7438	Debt Service-Interest	\$15,849	
7439	Debt Service-Principal	34,151	
9110	Cash (Vouchers Payable)		\$50,000
To record the second lease payment			

General Long-Term Debt Account Group

		<i>Dr</i>	<i>Cr</i>
9587	Obligation Under Capital Lease Agreements	\$34,151	
9685	Amount to Be Provided for Lease Payments		\$34,151
To reduce long-term debt as a result of the second lease payment			

If the lease payments are to be paid from a Debt Service Fund, any transfers from the General Fund to the Debt Service Fund are treated as operating transfers, not as General Fund expenditures.

The entries using the standardized account code structure (SACS) for a photocopy machine used in the accounting department would be recorded as follows:

General Fund			
		<i>Dr</i>	<i>Cr</i>
x-xx-xx	Equipment		
	01-0000-0-0000-7200-6400-000	\$208,493	
	Proceeds from Capital Leases		
	01-0000-0-0000-0000-8972-000		\$208,493
	To record the acquisition of equipment with a capital lease		

General Fixed Assets Account Group			
		<i>Dr</i>	<i>Cr</i>
x-xx-xx	Equipment		
	96-0000-0-0000-0000-9440-000	\$208,493	
	Investment in General Fixed Assets		
	96-0000-0-0000-0000-9990-000		\$208,493
	To record the asset		

General Long-Term Debt Account Group			
		<i>Dr</i>	<i>Cr</i>
x-xx-xx	Amount to be provided for Lease Payments		
	97-0000-0-0000-0000-9989-000	\$208,493	
	Capital Leases Payable		
	97-0000-0-0000-0000-9667-000		\$208,493
	To record the long-term debt resulting from a capital lease		

General Fund			
		<i>Dr</i>	<i>Cr</i>
x-xx-xx	Debt Service-Principal		
	01-0000-0-0000-9100-7439-000*	\$50,000	
	Cash		
	01-0000-0-0000-0000-9110-000		\$50,000
	To record the first lease payment		

*If a restricted resource authorizes the expenditure of funds for a capital lease, the appropriate resource and goal would be used.

General Long-Term Debt Account Group			
		<i>Dr</i>	<i>Cr</i>
x-xx-xx	Obligations Under Capital Lease Agreements		
	97-0000-0-0000-0000-9667-000	\$50,000	
	Amounts to be provided for lease payments		
	97-0000-0-0000-0000-9989-000		\$50,000
	To record the first payment (principal only)		

The second lease payment (6/30/93) would be recorded in the following manner:

General Fund			
		<i>Dr</i>	<i>Cr</i>
x-xx-xx	Debt Service-Interest		
	01-0000-0-0000-9100-7438-000	\$15,849	
	Debt Service-Principal		
	01-0000-0-0000-9100-7439-000*	34,151	
	Cash		
	01-0000-0-0000-0000-9110-000		\$50,000
	To record the second lease payment		

*If a restricted resource authorizes the expenditure of funds for a capital lease, the appropriate resource and goal would be used.

General Long-Term Debt Account Group			
		<i>Dr</i>	<i>Cr</i>
x-xx-xx	Obligation Under Capital Lease Agreements		
	97-0000-0-0000-0000-9667-000	\$34,151	
	Amount to be provided for lease payments		
	97-0000-0-0000-0000-9989-000		\$34,151
	To reduce long-term debt as a result of the second lease payment		

